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Harmful Tax Competition and Base Erosion

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Effect of BEPS Proposals

- **Enable strengthening of national tax powers**
- **Denial of deductions**
- **Complex rules for profit allocation (Transfer Pricing)**
- **Weak disciplines on tax competition**
- **Generalisation of regimes found non-harmful**
- **Counter-measures? Unlikely**
- **Defending the source tax base**
- **Minefield for advisers**

Stronger Powers to Deny Deductions

- **Limitation of interest deductions**
cap @ 10-30%
OR consolidated interest cost apportioned by EBITDA
- **Hybrid Entities or Instruments**
denial of deductions
to the extent that receipts untaxed due to hybrid
- **Denial of treaty benefits**
Principal Purpose Test
and/or Limitation of Benefits clause
(To be added to DTAs, perhaps via Multilateral Instrument)
- **Apportionment of Joint Costs?**
Only for low-value adding services &
subject to benefit test

Complex Rules for Profit Allocation: Transfer Pricing

- **Arm's Length Principle, but**
 - (i) powers to recharacterise transactions
 - (ii) comparability adjustments for 'location savings'
 - (iii) use of 6th method, for commodities
- **Recharacterisation**
Functions, Assets & Risk analysis
Also applies to Cost Contribution Arrangements
(+ benefit, power to control, financial capacity)

Controlling Tax Competition?

- **Harmful Tax Practices**
1998 Report + Forum (peer review)
applies to mobile activities, including intangibles
4 key & 8 other factors
- **BEPS 5: Substantial Economic Activity**
patents & functionally equivalent assets
'nexus' = qualifying expenditure
expenditure by taxpayer, directly connected to asset
Max. 30% uplift for contracted research/acquired assets
nexus ratio defines limit of income to benefit
- **Initial Review by Forum**
43 regimes, 16 for IP
all 16 found at least partially harmful
should be withdrawn/revised

Generalisation of incentive regimes

- **Patent box**
 - EU states (12 in 2014)?**
 - V. 2.0: UK, Ireland, Switzerland**
 - maybe Germany, US**
- **Notional interest deduction**
 - Belgium > Switzerland**

‘Defensive’ measures?

- **CFC rules**
 - could deter source tax base erosion solution for US?**
 - Action 3 recommendations weak**
 - 1998 mention of coordination dropped**
- **Competition to attract corporate HQs**
 - Belgium, UK, Ireland etc.**

Defending the Source Tax Base

- **‘Artificial avoidance’ of a P.E.**
UK , Australia
- **Services income**
PE if ‘furnished’ > 6 months (China, UN minority)
‘significant economic presence’ (BEPS Action 1)
- **Fees for Services**
WT on gross payment, hits consumer?
India, UN new article XX
- **Other Withholding Taxes**
Digital transactions (BEPS Action 1 report)
royalties, interest

Minefield for Advisers

- **Is Arbitration the answer?**
Only guarantees corresponding adjustment
- **Country by Country Reports**
will give overview
- **Responsible Tax Planning**
simplify complex structures
avoid havens/low tax regimes
profits should relate to economic activity
& value creation

**Thank You
Muchas Gracias
Obrigado**